



Directorate of
Intelligence

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International Economic & Energy Weekly

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**International
Economic & Energy
Weekly**

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**International
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Synopsis

Perspective—*Turkey's Prospects Under Democracy*

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Turkey's economic outlook on the eve of the country's return to democracy is reasonably good. We are cautiously optimistic that the new government will avoid past policy errors and generate sustained economic growth.

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International Financial Situation: Status of Multilateral Development Bank Lending

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This article is part of a special series on the economic and political aspects of the international financial situation. The article examines the status of multilateral development bank lending.

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International Financial Situation: Slow Growth Likely for ODA Flows to LDCs

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This article is another of the special series on the economic and political aspects of the international financial situation. This article examines the trends in official development assistance from industrial countries.

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Turkey: Postelection Economic Prospects

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The parliamentary elections on 6 November will not bring about major changes in economic policy. Turkey's economic rebound has lost some momentum this year but expansion should continue at least through 1984.

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Israel: Economic Problems Facing the Shamir Government

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New Finance Minister Cohen-Orgad faces a difficult task in restoring public confidence and in mustering support for his publicly professed goal of reducing personal consumption. Faced with a difficult economic situation and the attendant political pitfalls of austerity, the Shamir government most likely will look to the United States for more aid.

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Central America: Grim Economic Prospects

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Insurgent activity and the associated climate of uncertainty will remain the most critical factors influencing Central American economic performance at least through 1984.

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Perspective***Turkey's Prospects Under Democracy***

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Turkey's economic outlook on the eve of the country's return to democracy—legislative elections are scheduled on 6 November—is reasonably good. Although the pace of recovery has slowed sharply in 1983, following two years of dramatic progress, the economy is still moving in the right direction. Ankara is adhering rather well to the 1980 stabilization program, even though the program's author, Turgut Ozal, resigned from the government more than a year ago.

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We believe economic policy will not change much after the election. The two center-right parties that will almost certainly dominate the new legislature—one of them headed by Turgut Ozal—appear committed to maintaining the market-oriented approach that has worked well so far.

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The longer term outlook is much less certain. Talk of “dramatic progress,” although true, can obscure how far Turkey still has to go. Inflation has been cut by more than two-thirds but is still running at 30 percent. The State Economic Enterprises have become much more self-sufficient, but the government still subsidizes their investment outlays—to the tune of 3 percent of GNP. Unemployment growth has been slowed, but one worker out of five is still without a job.

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Turkey's membership in the OECD may also obscure the fact that it is not in the same economic league as the other members. Turkey's per capita GNP is less than half that of Portugal's—the next-poorest OECD country. Turkey is even further behind in terms of most material indicators of living standards.

It is also alarming that Turkey has now gone through three major economic crises in less than 30 years—and all three were largely of Ankara's own making. The first two episodes were cured by stabilization programs, backed by foreign assistance, but as soon as the memories of crisis faded, Ankara began to repeat the same policy mistakes. In particular, the exchange rate was allowed to become badly overvalued as Turkish governments made refusal to devalue the lira a point of honor. Government spending accelerated, monetary growth soared, and controls and subsidies multiplied. Given this track record, there is no guarantee that it will not happen again.

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Turkey also is torn by more than its share of factionalism—a constant threat to political as well as economic stability. Extremist groups—leftist, rightist, and religious—proliferated before the September 1980 military takeover. While such groups are banned from politics under the new Constitution, and while the military has ended the terrorism that was claiming 20 lives a day, no one doubts that the extremist feelings are still there. Turkey's comparatively low level of economic development, unequal distribution of wealth, ethnic divisions, and 25-percent illiteracy rate create a fertile breeding ground for such feelings to intensify. [REDACTED]

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Finally, Turkey remains a country torn between two worlds. Physically and culturally part of the Middle East, Turkey is still embarked on the hectic Westernization drive that Ataturk began half a century ago. [REDACTED]

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Turkey's multiple problems make long-term economic forecasting particularly risky. Nevertheless, we are cautiously optimistic that Turkey will avoid the old policy errors this time and generate sustained growth:

- The Turks seem finally to have learned the lesson of overvalued exchange rates—the single biggest cause of Turkey's three postwar economic crises. The exchange rate, which was not changed once during the 1960s, is now altered daily—and draws little or no comment. Since daily adjustments began in May 1981, lira devaluations have more than offset the inflation differential between Turkey and its trading partners.
- The more outward orientation of the economy seems to have taken root. Businesses are actively seeking export markets, Turkish construction firms are doing a booming business in the Middle East, Turkish banks are opening branches abroad, and the longstanding Turkish phobia against foreign investment appears to be fading.
- The new Constitution—by giving greater power to the president and severely impeding the formation of splinter parties—may forestall the political wrangling that in the past contributed to economic policy blunders.

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Briefs**Energy***Persian Gulf Oil
Transportation Costs
Edge up*

Anticipation of Iraq's acquisition of Super Etendard aircraft from France has begun to boost rates on world tanker and insurance markets. Since mid-October charter rates demanded by tanker owners for movements of crude from the Iranian export facility at Khark Island and the Arabian loading ports in the Persian Gulf have gone up several cents a barrel. Earlier in the month war-risk insurance on the value of cargo was increased by 3 cents a barrel. Although the war-risk hull insurance rates paid by owners of tankers in all areas of the Persian Gulf are remaining steady, underwriters have shortened the timespan during which hull insurance rates on ships trading at Khark Island and other Iranian ports are valid.

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**Transportation Cost of
Crude Oil From Khark Island
to Western Europe**

US \$ per barrel

	August- September 1982	1 October 1983	15 October 1983
Tanker charter rate	2.66	1.10	1.10
War-risk hull insurance on value of the ship ^a	0.17	0.04	0.04
War-risk insurance on value of cargo	0.94	0.11	0.14
Total cost to oil purchaser	3.60	1.21	1.24

^a Payable by shipowner, but passed on to purchasers of the oil as a component of charter rate.

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We believe the situation in the Gulf will have to deteriorate drastically to raise transportation costs to the peak of \$3.60 per barrel reached in August and September 1982, after the Iraqis sank freighters in the upper Gulf. During that period, the Iranians had to discount their Khark Island crude to compensate for the \$2.90 differential between the shipping cost for a barrel of their crude and the 70-cent shipping cost for a barrel from Arab suppliers in the Gulf. Although there is a surplus of tankers worldwide, an effective Iraqi campaign against tankers trading with Khark Island would cause underwriters to deny insurance coverage, and owners and crews probably would refuse to load at Khark.

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Secret***Status of Persian Gulf Oilspill***

An expected shift in prevailing winds this month could cause significant amounts of oil from the leaking and burning platforms in Iran's offshore Now Ruz oilfield to reach the Kuwaiti and northern Saudi coasts by the end of the year. [REDACTED]

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[REDACTED] The widely reported appearance of tarballs throughout the Persian Gulf indicates that currents have distributed submerged oil over a much wider area or that tankers are using the spill as an excuse to dump oil illegally. When the oilspill reaches the coasts of Kuwait and Saudi Arabia, it will pose a threat to major desalination and electric power plants in those countries. The spill, which is continuing at about 4,000 barrels per day, now totals some 1.5 million barrels.

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Renewed Interest in Saudi-Iraqi Pipeline

Riyadh may bow to Baghdad's pressure for access to an oil pipeline across Saudi Arabia because of Iraq's mounting financial difficulties and the poor prospects for reopening the pipeline across Syria. Saudi Foreign Minister Saud told Prime Minister Thatcher last week that negotiations between the Gulf Cooperation Council and Damascus to reopen the Iraqi-Syrian pipeline had "totally failed," according to the US Embassy in London. Saud says Iraq and Saudi Arabia are now working to link Iraq to the Saudi pipeline that extends to the Red Sea. He estimated construction would take about 12 months. [REDACTED]

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[REDACTED] the new Iraqi spur—with a capacity of up to 500,000 barrels per day—would be temporary until Baghdad could build a larger pipeline across Jordan to Al Aqabah. Iraq currently depends on a pipeline through Turkey to export 800,000 barrels per day. The existing Saudi pipeline is operating below its capacity and could carry the additional Iraqi crude oil.

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The Saudis have not been enthusiastic in the past about an Iraqi pipeline crossing their territory. They withdrew financial assistance for such a pipeline proposed in 1981, effectively killing that project, and the question of financing the new link still has to be addressed. [REDACTED]

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Iraq has to increase oil exports substantially to deal with its economic problems, but the pipeline will not provide immediate relief. If financial aid is not forthcoming, Baghdad could step up the war with Iran in an attempt to bring Tehran to the negotiating table. [REDACTED]

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*West Europeans Cool
on Spanish Gas
Pipeline Proposal*

The Spanish proposal for a pipeline linking Algerian and Nigerian gas sources to Europe across the Straits of Gibraltar has met a cool response from major West European gas consumers. According to government officials, France has no intention of buying additional quantities of Algerian gas because of past supply and price disputes with the Algerians and the already high level of dependence on Algerian gas. [redacted] West Germany see little merit in the proposal, citing potential unreliability of the suppliers and cost factors. Italian officials view the proposed project as redundant, stating that capacity of the existing Algerian-Italian pipeline could be doubled if demand was sufficient. The lack of consumer interest probably dooms the project and underscores the difficulty of bringing new supply projects on stream during this decade, including the development of several North Sea gas projects that would limit West European dependence on non-OECD gas supplies in the mid-1990s. [redacted]

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*EC Coal
Purchases Drop*

EC coal imports were down 20 percent in the first half of 1983, compared with year-earlier levels. High stocks and depressed demand cut sharply into import requirements, particularly in Belgium, Italy, and the Netherlands. High cost

EC: Coal Imports ^a

	Thousand Metric Tons		Percent Change
	1st-Half 1982	1st-Half 1983	
Total	35,105	28,231	-20
France	8,034	7,455	-7
Italy	8,145	6,492	-20
West Germany	4,144	3,732	-10
Denmark	2,955	2,815	-5
Netherlands	3,885	2,711	-30
Belgium/Luxembourg	5,016	2,486	-50
United Kingdom	2,256	1,764	-22
Greece	327	416	27
Ireland	343	360	5

^a Excludes intra-EC trade.

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This map illustrates the proposed natural gas pipeline network originating from Algeria. The legend in the top left corner defines the symbols: a solid line for 'Proposed pipeline', a dashed line for 'Existing pipeline', a rectangle for 'Existing LNG facility', and a triangle for 'Natural gasfield'. A scale bar indicates distances up to 1000 Kilometers.

The map shows three main proposed pipeline routes (A, B, and C) originating from the Hassi R'Mei gasfield in Algeria. Route A runs north through the Strait of Gibraltar to Spain and France. Route B runs east through Tunisia to Italy. Route C runs south through Niger and Nigeria to the Bonny gasfield on the Gulf of Guinea. The map also shows existing pipelines and LNG facilities in the region, as well as the locations of natural gasfields in Algeria and Nigeria. The map covers North Africa, the Middle East, and Southern Europe, with labels for various countries and bodies of water.

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US suppliers were the hardest hit, with EC purchases of US coal down nearly 35 percent to around 12.6 million metric tons. Both Poland and Australia significantly increased shipments to the EC, with supplies up some 30 and 50 percent, respectively. Stock drawdowns and weak demand are likely to continue to dampen import requirements for the remainder of the year. A recent EC estimate put 1983 imports at 63 million tons compared with 72 million tons last year. We believe imports are likely to be even lower. [REDACTED]

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Italian Coal Demand

Prospects for rapid growth in Italian coal use during the decade are dwindling rapidly as a result of transport problems, siting difficulties for new power plants, surplus Algerian gas and French electricity exports. Italy presently consumes around 20 million metric tons of coal—over 90 percent of which is imported—and unofficial government forecasts had called for this to increase to nearly 36 million tons by 1990. Italy is the second-largest overseas purchaser of US coal, importing 11 million tons last year. Because of difficulty in obtaining local and regional approval for new coal-fired electric generating plants, a government official has indicated proposals for new coal-fired plants have been temporarily shelved. The need to use Algerian gas under “take or pay” contracts, moreover, has caused at least one large plant to be slated for conversion from oil to gas rather than to coal. In addition, the French have recently offered surplus electricity to Italy at very competitive prices—a further disincentive to the construction of new coal-fired plants. [REDACTED]

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Japanese Divided on Issue of US Coal Imports

Recent Japanese press reports indicate that the Ministry of International Trade and Industry (MITI) is planning to switch the emphasis in the country's coal imports from Australia and other suppliers to the United States. Japanese steel industry executives, however, continue to indicate that increased purchases of US coal are unlikely due to declining steel production, realization of long-term coal development projects elsewhere, and the high cost of US coal. According to these executives, the steel industry—which accounts for around 80 percent of Japan's coal imports—is operating at only 60 to 70 percent of capacity, and production estimates for 1985 have been slashed by 18 percent. Moreover, the executives contend that realization of Japan's long-term coal projects with equity partners in Australia, Canada, China, and the USSR will compel the Japanese to use an even higher percentage of non-US coal in 1984. Because US coal is the most expensive, Japanese industrialists plan to stabilize purchases of US metallurgical coal at 10-12 million metric tons in the near term, compared with around 20 million tons in recent years. In the absence of a significant reduction in the cost of US coal, we believe Japanese Government pressure on industrialists to purchase additional quantities of US coal will have little effect. [REDACTED]

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*Colombian Coal
Marketing Efforts*

The Israel National Coal Company has signed a letter of intent with Carbocol—the Colombian state coal firm—for steam coal supplies from the El Cerrejon north zone. The contract is the fourth agreement the joint partners Carbocol and Intercor (an Exxon subsidiary) have lined up for the \$3 billion coal export project scheduled to begin operations in 1986. Denmark, Spain, and Ireland have already contracted for coal supplies, bringing current contractual commitments to about 3.5 million metric tons per year. With production planned to reach 15 million tons annually by the late 1980s, the partners are looking to other markets in Europe, the Far East, and the Caribbean. Colombian coal is expected to be competitive with low cost South African coal and some US coal producers are concerned it could make inroads in US Gulf Coast electric utilities. []

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International Finance*New Brazilian
Austerity Law Faces
Resistance*

Brasilia's substitute austerity law, decreed immediately after last week's congressional repeal of a controversial wage restraint law and three other unpopular measures, has drawn fire from major domestic political constituents and evoked concern from the IMF. While the progressive tax changes and sliding wage-adjustment scale contained in the substitute measure ease the burden on the lower-income classes, they further squeeze purchasing power in Brazil's influential middle class. According to the US Embassy, Brazil's financial and business community has harshly criticized the new law as severely recessionary and damaging to the middle class. Meanwhile, the IMF is concerned that the substitute legislation will be less effective in combating inflation and could invalidate Brazil's recently signed letter of intent. []

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We believe the new austerity law will require further negotiation with the opposition to assure congressional passage. According to the US Embassy, an attempt to railroad the new law through Congress most likely would be blocked by resentful opposition members and government party dissidents. Negotiating an acceptable compromise will require protracted talks—perhaps a month or more—and will add to foreign creditor uncertainty about the government's ability to enforce austerity. As a result, efforts to restore IMF support would stall and foreign bank loans would be delayed further. []

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*Argentine Moratorium
on Debt Payments*

Argentina is being forced into a de facto payments moratorium, which will cause severe economic problems for the new government. President Bignone, under pressure from nationalist elements, this week told international banks that debt negotiations were suspended until a civilian government can participate. A government is to be elected on 30 October, but it will not be installed until the end of the year. [] as a result, a \$500 million commercial bank loan will not be disbursed on 28 October. In a further complication, the IMF has not granted the waiver necessary to release \$320 million tied up since August. According to the US Embassy, recent increases

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in public-sector wages and the prices of state-supplied goods will put Argentina even more out of compliance with its IMF agreement and probably will result in the loss of another \$320 million payment scheduled for November. [REDACTED]

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The Central Bank projects that without these funds overdue debts will reach \$1.7 billion by the end of the year, as compared with less than \$100 million in net reserves. A decline in exports during the fourth quarter, increased capital flight, and large maturing debts are causing the deteriorating cash position. With Argentina unable to service its debts, a payments waiver by bankers is increasingly likely. The moratorium will result in the cessation of trade credits and any new foreign lending to the private sector. The reduction in imports and business investment will quickly be felt in higher prices—inflation already is at an annual rate of 925 percent—and a slowdown in economic activity.

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Negotiations over the financial impasse probably will be even more difficult with a new civilian government. It will have difficulty imposing the austerity measures likely to be required by bankers for a resumption of financial assistance and at least initially would have to live with election campaign pledges to obtain more favorable terms than those that were offered to the Bignone regime. [REDACTED]

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*Colombian Financial
Pressures Intensify*

Bogota is scrambling to cover its widening payments deficit. Despite tougher import and exchange controls, recently released government statistics indicate Colombia posted an estimated \$700-800 million current account deficit during the third quarter of this year, 30 percent larger than the same period a year earlier. According to the US Embassy, the weaker current account stems from declining earnings from exports, tourism, and worker remittances. Bogota so far has managed to cover the payments gap by drawdowns in liquid reserves; they declined 30 percent between 30 June and 30 September to \$1.6 billion. Additional drawdowns, however, could deplete the liquid reserves within the next six months. [REDACTED]

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*Nigeria Placates
Bankers*

Nigeria has resumed paying off debt obligations to select US and European banks after previously failing to make payments on letters of credit. The Nigerian action followed a threat by one US bank to initiate default proceedings [] debt rescheduling agreement signed last July. Such a move, however, requires the support of banks holding at least two-thirds of the rescheduled debt, and most are willing to give Lagos until the end of October to settle arrears. []

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Nigeria's inability to make payments on time apparently results more from bureaucratic ineptitude than a foreign exchange shortage. Trade data through June 1983 indicate monthly imports are averaging \$600 million; export receipts are running about \$950 million a month. Nevertheless, we anticipate further payments problems, hampering the Shagari government's ability to attract additional funds and reschedule the remainder of its estimated \$5 billion in unpaid trade credits. Settling up with the banks is certain to be a condition for an Extended Fund Facility agreement with the International Monetary Fund and bankers do not expect that an IMF letter of intent will be signed before early next year. Talks with the Fund are behind schedule because of the recent Nigerian elections and uncertainties over the Fund's ability to provide new loans. []

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*Ivory Coast Averts
Debt Rescheduling*

Ivory Coast, Sub-Saharan Africa's second largest debtor after Nigeria, continues to keep one step ahead of having to reschedule its \$7 billion foreign debt. Abidjan last month secured a \$75 million bridge loan from 10 international banks. The funds should allow the country to keep current on its debt servicing obligations until November, when cocoa and coffee earnings start to come in. Last year, Abidjan was able to put off a formal rescheduling only after the French Government made payments to French banks—Ivory Coast's primary creditors—on Abidjan's behalf and pressured the banks to defer principal and interest payments. []

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Prospects for sidestepping a debt rescheduling in 1984, however, look bleak. Principal payments on debt incurred since 1979—nearly half of Ivory Coast's total external obligations—will begin to come due then, boosting estimated debt service requirements from \$1.4 billion this year to more than \$2 billion. The Ivorian Government, well aware of the financial crunch ahead, has already called a meeting of the country's major lenders in December to discuss a loan package. We believe Abidjan's prospects for such a loan are seriously clouded by the reluctance of international bankers to step up lending to troubled LDCs and by signals from Paris that financial problems preclude continued French support at current levels []

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*Portuguese
Syndicated Loan*

Lisbon's seven-year loan syndication has been oversubscribed, and the amount has been raised from \$300 million to \$350 million. In addition, a two-year \$150 million revolving trade credit facility is being marketed. Competitive pricing of the seven-year loan, Lisbon's agreement to pursue an IMF

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stabilization program, and sharp improvements in Portugal's current account deficit have renewed the financial community's willingness to extend financing. [] The seven-year loan will be in two tranches, one carrying an interest rate 0.5 percentage point over the US prime rate and the second paying 0.875 percentage point over LIBOR. [] [] general syndication probably will be completed by the end of October and that disbursement will take place early in November. []

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Global and Regional Developments

EC-US Dispute on Specialty Steel

EC foreign ministers last week agreed to step up pressure on the United States to settle the dispute over US restraints on specialty steel imports. The Community has rejected the most recent US offer to reduce tariffs on a variety of products as compensation for the duties and quotas it imposed on EC specialty steel last July. The EC is seeking US tariff reductions worth at least \$500 million—more than double the recent US offer—and has filed a complaint against the United States within the GATT. The EC warned last summer that it would retaliate against the United States if no acceptable compensation arrangement could be worked out and has set a 30 November deadline. Deliberations at the recent foreign ministers meeting indicate the EC might retaliate by raising tariffs against US exports of computers, office equipment, radio and TV equipment, textiles, and steel tube and pipe fittings. About 45 percent of total US exports of computers and office equipment goes to the EC. []

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Status of Proposed Hungarian-EC Trade Agreement

EC member states last week endorsed the Commission's negotiations with Hungary for a trade agreement and urged Commission Vice President Haferkamp to draft a bilateral protocol as soon as possible, according to US Embassy reporting. The Hungarians requested a trade agreement last April to gain access to EC markets for beef and industrial exports and, in recent weeks, they have pushed hard on this issue during high-level meetings with the West Germans. Budapest's pursuit of an agreement is part of a broader strategy of turning to the West to improve its precarious balance-of-payments position. Negotiations over specific concessions, however, are likely to be protracted. The West Germans and British apparently favor an agreement in order to loosen Hungary's ties to the East, but the French and Italians fear increased competition from Hungarian agricultural products. While Budapest probably notified Moscow before approaching the EC for exploratory talks, the Soviets may be concerned that closer ties with the EC could reduce Hungary's traditional role as a food supplier to other CEMA countries. []

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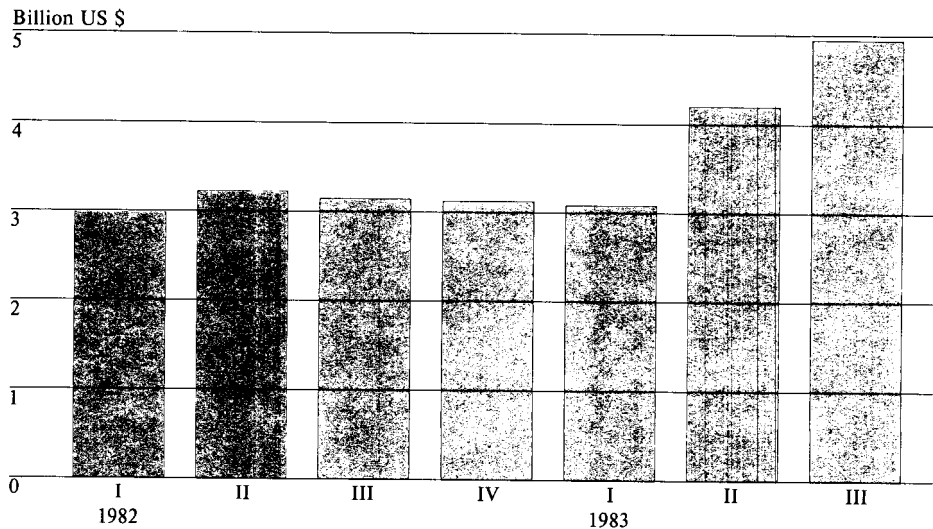
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National Developments***Developed Countries******Japanese Trade
Surplus With the
United States Growing***

Japan's bilateral trade surplus with the United States is growing rapidly. Through September the surplus on a customs clearance basis was \$12.2 billion, a 31-percent increase over the same period a year earlier. If the trend continues—and that appears likely—the 1983 surplus could reach \$18 billion. The weak yen, sluggish Japanese demand, and the US recovery are the major reasons for the trade gap. Japanese shipments of manufactured goods have been especially strong since the second quarter as US distributors began rebuilding inventories. Japanese purchases of US products have declined 2 percent this year.

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Japan: Trade Surplus With the United States

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***Japanese Economic
Stimulus Package***

The Cabinet last week approved an economic program designed to dampen foreign criticism of its growing trade surplus. Tokyo probably views the package mainly as a means of demonstrating good will to Washington before President Reagan's visit and of diverting public attention from the bribery verdict against former Prime Minister Tanaka. Highlights of the plan include a 0.5-percentage-point cut in the discount rate, reduced tariffs on 44 industrial items, slightly lower personal income taxes, and introduction of low-interest-

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rate loans for import financing. Some measures that had been under consideration, including an investment tax credit for small businesses, were dropped from the package for budgetary reasons or because of public opposition.

The package will do almost nothing to restrain the growth of the current account surplus in 1983, and it will have only a limited impact in 1984. The tariff reductions and the bulk of the tax cuts will not take effect until next April. The cut in the discount rate—intended to spur domestic economic activity—could have an adverse effect on Japan's trading partners. If sufficient capital flows out of Japan in search of higher interest rates overseas, this could cause the yen to decline and strengthen Japan's export competitiveness.

*MITI Plans Extension
of Voluntary Auto
Restraint*

Japan will extend its voluntary curb on automobile exports to the United States for one more year but will push the United States for an increase in the yearly quota allotment to 1.9 million vehicles starting 1 April 1983 from the current 1.68 million vehicles. An increase in the quota allotment is necessary so that Susuki and Isuzu can fulfill their agreement to supply 180,000 subcompacts to General Motors during 1984. Difficulties over distribution of the quota allotment among the Japanese automakers may develop if the increase is not large enough to accommodate Susuki and Isuzu plans for increasing exports.

*EC Disagrees Over
Industrial Policy*

The French have proposed "significant but temporary increases" in EC external tariffs on finished products, accompanied by greater constraints on products assembled in the EC from imported components. such attempts to close EC markets would aggravate current EC-US strains over the Community's agricultural policy. Economics Minister Otto Lambsdorff also criticized the French plan as just another way for Paris to get more money out of EC coffers.

the growing interest within the Community for an EC-wide industrial policy but indicates that future EC debate over this issue could become increasingly contentious. Bonn, has reacted more favorably to a British paper featuring a free market approach to industrial policy and less reliance on EC funding. France's EC proposals closely follow its national policy, which emphasizes substantial government involvement in industrial development and limits competition between firms. The French are pressing for new protective barriers because they believe that emerging West European high-tech industries—particularly their own—can compete only within a protected and

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regulated EC market sheltered from US and Japanese competition. Paris will continue to push its EC partners on industrial policy and is likely to intensify its efforts when it assumes the EC presidency in January 1984. []

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*Increased Canadian
Foreign Investment
Approvals*

Since mid-1982, Canada's Foreign Investment Review Agency (FIRA) has approved 94 percent of new foreign investment applications, as compared with an average of 91 percent through 1974-82. We believe this increase can be attributed more to Canada's deep recession than to substantive and procedural changes made to FIRA in July 1982. The changes reduced the review period and clarified previously ambiguous application procedures but did not free the review process from political considerations; final Cabinet approval of applications is still necessary. The sharp drop in economic activity in 1982, however, emphasized the Canadian economy's need for increased investment—foreign and domestic—and the Cabinet appears to have unofficially eased requirements that foreign investments yield significant benefits to Canada. Now that economic recovery is under way, Ottawa is likely once again to levy more restrictive requirements on foreign investment since most senior government officials still believe that FIRA should be used to promote their nationalist approach to economic affairs. []

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Ottawa currently is studying a July GATT panel report which found aspects of FIRA to be in violation of international trade regulations. Government officials hope that FIRA's recent performance and the changes already implemented will soften criticism of Canada's foreign investment review process when the issue comes before the full GATT assembly at its next meeting in November. Whatever the decision of the GATT assembly, the current Liberal government is unlikely to change substantially the popular FIRA, particularly since the Liberals are preparing for an election that probably will be held in late 1984. []

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Less Developed Countries

*Grenada's Potential
Foreign Exchange
Needs*

The probable reorientation of Grenada's Government will spark requests for US aid. We estimate that to maintain imports close to the 1982 level of \$70 million, Grenada could need as much as \$40 million through 1984 to replace sources of foreign exchange lost because of the expected change of government and concern over unsettled conditions. We foresee dropoffs of capital inflows from commercial banks, official aid (primarily from Cuba), and tourism revenues. []

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*Further Philippine
Unrest Expected*

The poor economy is leaving President Marcos little room to maneuver to stem growing political disaffection with his regime. Labor strikes last week involving approximately 50,000 workers added fuel to opposition demands for

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Marcos's resignation. The strikes shut down the Bataan Export Processing Zone, disrupted international communications, and closed roughly half the city's elementary and high schools. Further unrest is likely as recent austerity measures will cause additional layoffs and price hikes. [REDACTED]

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Moderate opposition leaders presumably believe that the economic situation will help them by keeping the business community and labor groups firmly in their camp. They are holding out for additional political concessions by Marcos before agreeing to take part in National Assembly elections scheduled for next year. Radical groups, meanwhile, are blaming the United States for the economic crisis. Marcos's use of harsh methods to break up strikes and demonstrations will further damage the President's poor public image. [REDACTED]

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*Possible Policy
Changes in Chile*

Political maneuvering over economic policy is likely to result in the replacement of Finance Minister Caceres and new policies aimed at stimulating the economy. US Embassy and press reporting indicate that Caceres only narrowly escaped being fired on 14 October and that his tenure is expected to be short. [REDACTED] Interior Minister Jarpa is urging President Pinochet to replace Caceres to clear the way for more expansionary economic policies. Jarpa believes such policies would aid him in negotiations with opposition elements on the transition to civilian rule. [REDACTED]

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Most Chileans would welcome a rapid reactivation of the economy. Growth-oriented policies, however, probably would result in a rapid monetary expansion that would accelerate inflation. This would endanger agreements with the IMF and with commercial banks whose credits are necessary to avert a foreign financing crisis. [REDACTED]

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*Zimbabwean Austerity
Measures*

Drought and a worsening foreign exchange shortage have resulted in tough new austerity measures. Agricultural production is projected to fall 20 percent this year, led by a 50-percent drop in corn, the staple of the diet. The government earlier this month announced Zimbabwe's first-ever corn rationing in an effort to stretch supplies until next April's harvest. Harare also decided to reduce foreign exchange allocations to importers through 1984.

[REDACTED]

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While import restraints will help hold the current account deficit this year to about \$600 million compared with \$730 million in 1982, fundamental problems persist. Prices for Zimbabwe's principal mineral exports—including gold, chrome, and copper—have not yet recovered from the world recession.

[REDACTED]

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Repayments of short-term debts, set to begin next year, will create additional strains. [REDACTED]

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*Venezuelan Oil
Production and Exports*

Venezuelan oil output—including natural gas liquids—averaged 1.8 million b/d during the first eight months of 1983, according to US Embassy reporting of recent official data. During the April to August period, production averaged just over 1.7 million b/d, slightly above the OPEC production quota assigned to Venezuela in March. Caracas has been able to meet domestic consumption and maintain exports of crude oil and refined petroleum products at an average of 1.53 million b/d this year—only 70,000 b/d below the 1983 budgetary planning goal—by taking about 200,000 b/d of oil out of storage. []

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[] Venezuelan export earnings have been reduced to about \$25 per barrel, \$2 less than projected in January. As a result, oil revenues for the year are expected to be about \$14 billion—\$2 billion below what Caracas had hoped to receive. []

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*Government Financial
Crisis in Lesotho*

The government of Lesotho is experiencing a cash crunch midway through its fiscal year and will have trouble financing a budget deficit projected to reach \$60 million, according to the US Embassy. Unexpected drought relief costs and politically motivated extrabudgetary spending are primarily responsible. Maseru plans to seek commercial loans in South Africa to finance government operations through next March, and economic officials have outlined an austerity budget for 1984-85. []

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Some Lesotho officials have proposed approaching the IMF or the South African Government for help. Neither option is attractive to the government. Tougher austerity under an IMF accord probably would further undercut popular support for Prime Minister Jonathan's regime, according to the US Embassy. Relations with Pretoria have deteriorated sharply this year, and appealing to South Africa would risk Pretoria's increased use of its economic leverage to gain political and security concessions from Lesotho. []

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*Communist**USSR's Hard
Currency Oil Exports
Down in First-Half
1983*

Soviet shipments of crude oil and oil products to OECD countries for hard currency declined by only about 2 percent in the first half of 1983 compared with first-half 1982, according to preliminary OECD data. Because of the drop in oil prices, the resulting decline in hard currency earnings was probably about 10 percent. If the decrease in Soviet oil exports for hard currency continues for the rest of 1983, hard currency oil earnings could fall by about \$1.5 billion from the record \$14.8 billion in 1982. Last year's exports of about 1.24 million b/d provided more than half of Moscow's hard currency receipts from commodity exports. []

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*USSR Diversifies
Imports of
Superphosphoric Acid*

The USSR is seeking to diversify sources of imported superphosphoric acid because of a perception of US unreliability and a need to boost phosphate fertilizer production in accordance with the Food Program. The Soviets plan to purchase a minimum of 700,000 tons of high-quality superphosphoric acids a year under a 10-year contract with Tunisia, [REDACTED]

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Trade with Tunisia would most likely begin sometime after 1985 following completion of a superphosphoric acid plant in Rehesa, Tunisia. The Soviets recently approached Morocco with a similar offer. Current Soviet import requirements are about 1.5 million metric tons a year, [REDACTED]

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[REDACTED] this requirement will increase to 2 million tons a year by the end of 1984. About 700,00 tons of superphosphoric acid now come from the United States as part of a long-term agreement. [REDACTED]

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**International Financial Situation:
Status of Multilateral
Development Bank Lending**

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This article is part of a special series focusing on the economic and political aspects of the international financial situation.

Multilateral development banks have been able to steadily increase lending to LDCs during the current financial crisis. According to data from public reports of the four major development banks (the World Bank, Inter-American Development Bank, Asian Development Bank, and African Development Bank), their net new lending to LDCs increased by \$1.5 billion in 1982 to \$8.8 billion. This compares to the nearly \$10 billion falloff in commercial bank lending to \$36 billion in 1982. We estimate that the development banks this year will lend close to \$12 billion to LDCs, while new commercial bank lending will have fallen another \$10-11 billion to only \$25 billion.

Role of Development Banks

The decline in commercial lending to LDCs has renewed the importance of the development banks as sources of funds, especially in the key, more

developed LDCs that are heavily in debt. As LDCs such as Mexico, Brazil, Argentina, the Philippines, Nigeria, and South Korea intensified their development spending in the 1970s, commercial banks replaced official institutions as primary sources of external financing. Last year, however, nearly one-half of loan disbursements from the multilateral development banks went to these six countries, a trend that is continuing through 1983. This year Brazil, for example, will depend on the multilateral development banks for almost 15 percent of its net new borrowing.

We expect the multilateral development banks to continue to play a strong role in financially troubled LDCs through at least the next several years:

- commercial banks have, for the most part, withdrawn from project financing because of the high risks of cost overruns and inadequate and inconsistent revenue generation to guarantee repayment.
- LDCs have had to cut back sharply new development spending to comply with IMF criteria for

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Multilateral Development Banks: Net Loan Disbursements Billion US \$

	1980	1981	1982	1983 ^a
Total	6.2	7.3	8.8	11.5
World Bank	4.6	5.6	6.6	8.9
Inter-American Development Bank	0.9	1.0	1.3	1.5
Asian Development Bank	0.5	0.6	0.7	0.8
African Development Bank	0.2	0.1	0.2	0.3

^a Projected.

Multilateral Development Banks: Loan Commitments and Disbursements to Major LDC Borrowers, 1982 Billion US \$

	Commitments	Disbursements
Total	5.5	4.1
Brazil	1.9	0.9
Mexico	1.2	1.5
South Korea	1.1	0.8
Philippines	0.8	0.4
Argentina	0.4	0.3
Nigeria	0.1	0.2

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budget deficits and inflation; at the same time, these austerity measures are forcing the multilateral development banks to assume a larger share of the financing burden for projects already under way.

- The multilateral development banks will continue to be the key source of project financing for poorer LDCs that lack access to commercial financing.

The multilateral development banks are likely to remain pressed for funds for several years until economic and political conditions in the industrial countries improve sufficiently to allow an increase in the banks' supplies of loanable funds. Until then, the development banks will probably step up the rate of disbursements on existing projects, while slowing new commitments to all but the advanced LDCs that have more economically viable projects and more political clout within the banks.



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Resource Squeeze

Against this backdrop of rising demands for multilateral development bank financing, the banks themselves are under a resource squeeze:

- Industrial countries are reluctant to contribute substantially greater funds to the multilateral banks. The World Bank, for example, is currently debating a proposed \$17 billion increase in its membership quota to parallel the quota increase granted the IMF; several of the industrial nations are instead proposing an increase of only \$3 billion.
- Global recession has slowed receipt of contributions already promised to development banks. As of June 1983, for example, the World Bank had received only 45 percent of the capital increase agreed in 1981 and has been urging members to accelerate their payments.
- The appreciation of the dollar during the past two years has eroded the value of the nondollar contributions to the banks from other industrial nations.
- As a result of the generally high interest rates in the past three years, the cost of funds borrowed by the multilateral development banks themselves has risen. This year, for example, the World Bank's cost of borrowing from private banks has averaged 9.4 percent, compared with 7.4 percent in 1981.

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International Financial Situation: Slow Growth Likely for ODA Flows to LDCs

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This article is part of a special series focusing on the economic and political aspects of the international financial situation.

Official development assistance (ODA) from industrial countries to developing countries and multilateral institutions remains a relatively small but important portion of total resource flows, particularly with the large cutbacks in private lending during 1982-83. We do not expect ODA flows to increase sharply during the next few years, but maintenance of current levels is important for LDCs. The least developed countries receive nearly one-fourth of total bilateral development assistance

and have little access to alternative sources of funds. Contributions by industrial countries to multilateral institutions also are crucial to LDCs, but we expect future growth to be limited at best.

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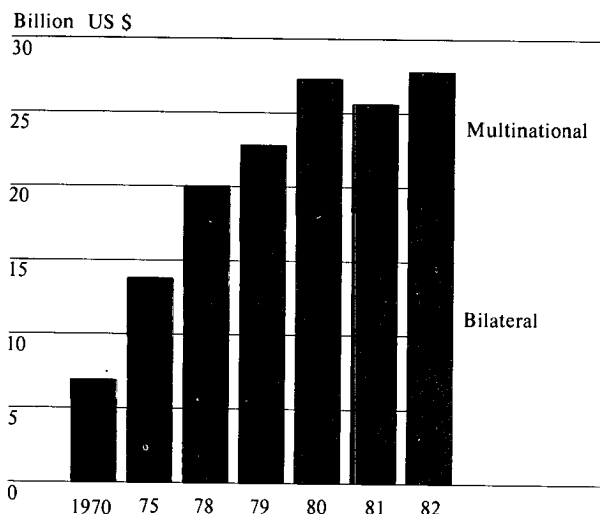
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Results in 1982

According to data recently published by the OECD, net disbursements of ODA totaled \$27.9 billion in 1982, a 9-percent increase from the 1981 total. The increase is misleading, however, as delays in disbursements of ODA to multilateral institutions caused 1981 figures to be understated and 1982 figures to be overstated. The average for 1981-82 is less than the 1980 total with the decline coming from reduced flows to multilateral institutions, which absorb about 30 percent of total ODA.

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DAC/ODA: Net Disbursement Aid Flows



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The major LDC recipients of ODA by region are Asia and Africa, where most of the countries have limited access to private sources of funds and rely heavily on official flows. Egypt, India, Bangladesh, Tanzania, and Pakistan are among the largest recipients. Indonesia, a major exception, has borrowed heavily from private capital markets, although the country has more debt outstanding to official sources than private.

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Only four of the 20 largest ODA recipients are experiencing major debt problems. Sudan and Zaire, which have deeply entrenched domestic economic problems, have been undergoing debt re-scheduling for the better part of the last decade; Morocco and the Philippines have only recently run into debt servicing difficulties. For all four countries, ODA flows are an important source of funds but have been inadequate to ease substantially their

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**DAC Countries: Net Disbursements
of Official Development
Assistance, 1982**

	Million US \$	Percent of GNP
DAC total	27,851	0.38
United States	8,202	0.27
France	4,028	0.75
West Germany	3,163	0.48
Japan	3,023	0.29
United Kingdom	1,793	0.38
Netherlands	1,474	1.08
Canada	1,197	0.42
Sweden	987	1.02
Australia	882	0.57
Italy	812	0.24
Norway	559	0.99
Belgium	501	0.60
Denmark	415	0.77
Austria	354	0.53
Switzerland	252	0.25
Finland	144	0.30
New Zealand	65	0.28

financial strains. The Philippines, for example, has debt servicing payments of some \$3.5 billion this year, compared with ODA receipts on the order of \$300 million.

The OECD's official target for individual country aid disbursements is 0.7 percent of GNP but only five of the 17 countries in the OECD's Development Assistance Committee (DAC) exceeded that level in 1982. The attainment of the 0.7-percent target would ease the payments situation of LDCs but would not cover their entire financing needs. For example, achieving the 0.7-percent mark in 1982 would have produced a total of \$50 billion in aid compared with the \$90 billion LDC current account deficit.

Outlook

We expect 1983 ODA totals to increase only slightly, to \$28-30 billion. The rate of growth will probably be slower than in previous years and the ODA/GNP ratio will remain at about 0.4 percent. For 1984, we expect a similar pattern. These estimates depend on several factors:

- For countries that have adopted GNP-related targets, ODA prospects depend directly on world economic recovery.
- In countries such as the United Kingdom and Canada, successful efforts in fighting inflation would ease budgetary constraints on the expansion of ODA, but other priorities could limit increases.
- Contributions of ODA to multilateral organizations by individual countries could be delayed because of debate in the United States over IMF/IBRD quota increases and the linkages between US agreement and other donors' commitments.

The ODA outlook for individual industrial countries varies considerably. Countries that have adopted GNP-related targets in recent years—including Austria, Canada, Finland, France, Italy, and Japan—will most likely undergo fairly rapid and sustained ODA growth over the next few years, according to the OECD. Countries with the highest ODA/GNP ratios—Denmark, Netherlands, Norway, and Sweden—will probably continue to increase ODA flows roughly in line with GNP growth. Modest ODA increases may be forthcoming from Australia, Belgium, and Switzerland.

The outlook for three major donors—West Germany, the United Kingdom, and the United States—is one of marginal growth at best. The OECD expects the growth of German ODA in 1983-86 to be modest—about 4 percent in current prices—because of a restrictive budgetary policy; the ODA/GNP ratio is likely to decline. UK aid will

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probably remain stable in the next few years with perhaps a slight increase as the British economy works its way out of recession. US officials expect a slight increase in US bilateral ODA, but the outlook for multilateral ODA is uncertain.

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Turkey: Postelection Economic Prospects

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The parliamentary elections on 6 November will not bring about major changes in economic policy. Only three parties are participating, and the two center-right parties certain to dominate the new legislature have campaigned on a platform of maintaining the market-oriented, outward-looking economic policies adopted in 1980. Moreover, the current military rulers will play an important role for several more years. []

Following two years of extraordinary gains, Turkey's economic rebound has lost some momentum this year, but expansion should continue at least through 1984. Export growth has slowed because of reduced sales to OPEC countries and a poor harvest has cut GNP growth this year to 3 to 4 percent; exports and GNP should both do better in 1984. The country's most intractable problem is its 20-percent unemployment rate, and inflation remains at about 30 percent. Although aid inflows are declining, we do not believe Turkey will have much difficulty in financing its current account deficit either this year or next. []

The Slide Into Crisis: 1973-79

The seeds of Turkey's economic difficulties were sown by the 1973/74 oil crisis—the huge oil price hikes created a new economic environment to which Ankara failed to adapt. Always jockeying to stay in power, the weak coalition governments that ruled Turkey in the 1970s were reluctant to take unpopular steps. Prices of oil and other goods thus were held down by a combination of price controls, subsidies, and an overvalued exchange rate. To offset the deflationary impact of the higher oil import bill, Ankara embarked on a massive spending program that pushed government outlays as a share of GNP from about 23 percent in 1973 to 27 percent in 1977. []

For about four years Ankara's strategy gave the appearance of working, as Turkey averaged real GNP growth of 7 percent annually from 1973 to 1977 while the rest of the world experienced a deep recession. Beneath this facade, however, problems mounted. The public-sector borrowing requirement soared, monetary growth accelerated, and between 1973 and 1977 the inflation rate doubled to 47 percent. The combination of higher oil prices and an overvalued exchange rate wrought havoc on the current account balance, which plunged from a \$0.5 billion surplus in 1973 to a \$3.4 billion deficit in 1977. Through 1977 the expanding deficit was financed mainly by reserve drawdowns and short-term borrowing. []

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The string ran out about mid-1977 when foreign banks, realizing that Turkey would soon be unable to meet its debt service obligations, cut off the flow of loans. Turkey was forced to slash imports—which plunged about 40 percent in volume terms from 1977 to 1979. Half-hearted stabilization programs failed in 1978 and in 1979; the government deficit remained large, monetary growth accelerated further, pushing inflation above 80 percent by yearend 1979. The effects of two devaluations were quickly eaten away by soaring prices. While reduced imports lowered the current account deficit, they also caused shortages that disrupted production. As a result, real GNP grew only 2.9 percent in 1978, and in 1979 declined for the first time in 25 years. []

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By yearend 1979 the Turkish economy was in a full-blown crisis, to which the second massive OPEC oil price hike dealt the final blow. Inflation was near triple digits and rising while production was falling mainly because of a lack of imported inputs. Fuel shortages disrupted the transportation

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system and caused daily blackouts in major cities, while the lack of heating oil forced many to endure an unusually cold winter without heat.

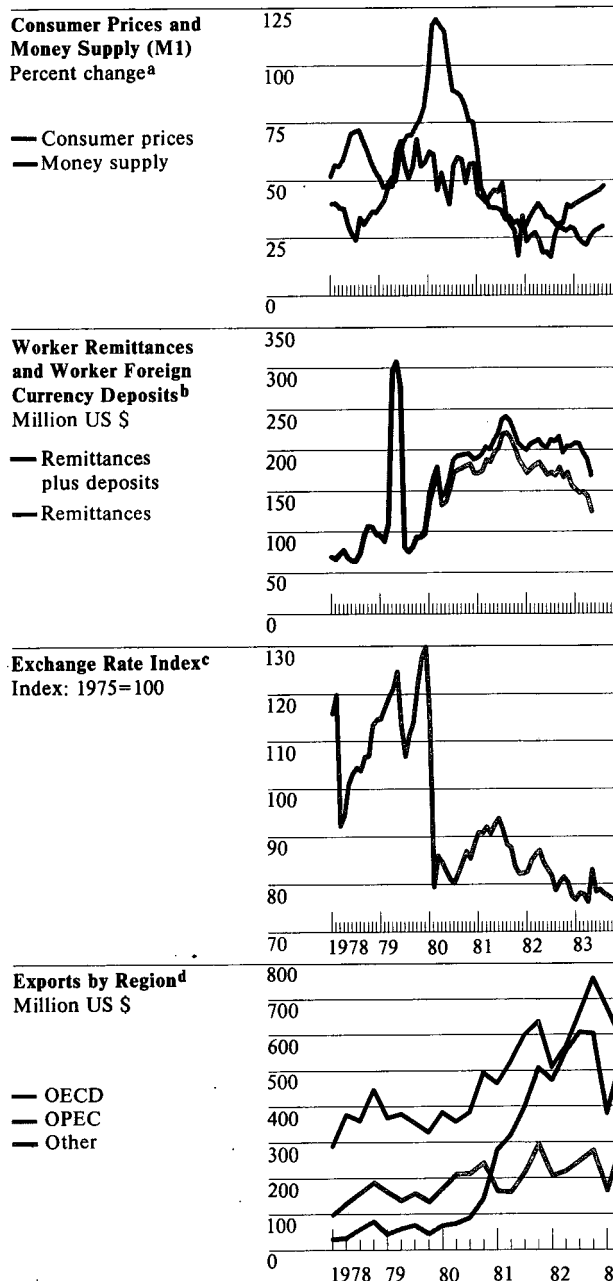
Rapid Recovery: 1980-82

In the fall of 1979, a coalition headed by the conservative Justice Party came to power and chose the internationally respected economist Turgut Ozal to draft a serious stabilization program. Announced in January 1980, the program aimed for nothing less than a fundamental restructuring of the Turkish economy by making it more responsive to market forces and more oriented to the outside world. A large devaluation was implemented and—in a sharp break with past policy—several follow-up devaluations were carried out later in the year. Prices charged by the State Economic Enterprises were raised sharply, in order to reduce the cost of government subsidies, and these firms were given greater autonomy. Other important policy changes included the lowering of barriers to foreign investment in Turkey, the removal of price controls, cuts in government spending and large increases in interest rates—which had been substantially negative in real terms.

Turkey's stabilization effort received generous support from the OECD countries, the IMF, and the World Bank. Aid provided in 1980, including debt rescheduling, totaled \$4.0 billion, more than double the 1979 amount. The increase in aid, however, was almost completely offset by the increase in Turkey's oil bill in 1980 in the wake of the OPEC price hike.

The September 1980 military takeover brought with it a reinforcement of the stabilization program. The generals immediately banned strikes, which had been running at exceptionally high levels and disrupting production. They soon implemented a tax reform that boosted revenue and distributed the tax burden somewhat more equitably. In 1981 Ankara moved to a system of daily exchange rate adjustments and also took further steps to improve the efficiency of the public-sector firms.

Turkey: Economic Indicators



^a From 12 months earlier.

^b Seasonally adjusted, 3 month moving average.

^c Trade-weighted and inflation-adjusted.

^d Seasonally adjusted, quarterly data.

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The stabilization program brought dramatic results during its first three years, especially with regard to the balance of payments. The monthly inflow of worker remittances doubled within about six months; exports responded more slowly but by 1982 were 150 percent above the 1979 level. Higher foreign exchange earnings enabled Turkey to increase import volume by 40 percent during these three years—despite higher oil prices—and still hold the 1982 current account deficit well below the 1979 level. With import shortages alleviated, economic growth resumed in the fall of 1980 and real GNP grew more than 4 percent during each of the next two years. Inflation meanwhile declined fairly steadily, to an annual rate of slightly below 25 percent in early 1983. []

Situation in 1983

Turkey's recovery has continued in 1983, albeit at a much slower pace. For the most part the slowdown resulted from factors beyond the government's control. Contrary to some fears, Ankara did not deviate significantly from its stabilization policy following Turgut Ozal's resignation in mid-1982. []

Ankara, however, has allowed a surge in the money supply that Ozal might have prevented. Fearing a banking crisis last year after the failure of several money brokers, the central bank pumped reserves into the system. As a result, the money supply expanded almost 50 percent during the 12 months ending in August 1983. This surge is the main reason that inflation has accelerated to about 30 percent. []

Ankara has taken action to strengthen the recovery. The pace of lira devaluation was stepped up, slightly more than offsetting the inflation differential between Turkey and its trading partners. The government moved to strengthen management of public-sector firms. Furthermore, an important bank reform law was passed that should improve the efficiency and stability of the banking system. []

First-half 1983 exports were up only 5.3 percent from the year-earlier period, a sharp decline from the 1980-82 growth pace. The main reason was the contraction in demand from OPEC countries, which accounted for 39 percent of Turkey's exports in 1982. Exports to OPEC were down 11 percent in the first half due mainly to a 75-percent plunge in sales to Iraq. Exports to OECD countries were up a healthy 20 percent in the first half, while industrial exports rose 23 percent. []

We think the trade deficit for the year will total about \$3.1 billion, the same as last year and \$0.3 billion larger than Ankara's forecast. Exports should pick up a bit in the second half and total \$6.1 billion for the year, versus Ankara's original target of \$6.6 billion. Imports for the year should be up about 4 percent to \$9.2 billion. []

Recorded worker remittances are off sharply in 1983 and probably will be down by about one-fifth for the full year, to \$1.8 billion. Most of the missing \$400 million will return to Turkey, however, in the form of workers' foreign currency deposits—a device encouraged by Ankara. Because the workers can withdraw their deposits later, the funds are considered short-term capital flows. In fact, the withdrawal rate is extremely low and Ankara meanwhile has the use of the foreign exchange. []

The current account deficit for 1983 probably will be close to last year's \$1.3 billion figure. Although this is double Ankara's target, it would not be a bad performance considering the weak OPEC market and the conversion of some worker remittances into capital inflows. We do not think Ankara will have problems financing the deficit. Foreign aid, although down from last year, will cover most of it, and private foreign investment will help some. Turkey also is slowly recovering its ability to tap private capital markets, as evidenced by the \$205 million credit approved last month by American Express Bank. []

Real GNP growth will slow to 3 to 4 percent this year, due almost entirely to a drop in agricultural

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Turkey: Balance of Payments*Million US \$*

	1979	1980	1981	1982	1983 ^a
Trade balance	-2,808	-4,999	-4,230	-3,097	-3,100
Exports	2,261	2,910	4,703	5,746	6,100
Imports	5,069	7,909	8,933	8,843	9,200
Invisibles balance	1,158	1,319	1,888	1,830	1,730
Worker remittances	1,694	2,071	2,490	2,187	1,800
Interest payments ^b	-1,010	-1,138	-1,443	-1,566	-1,370
Tourism (net)	179	212	277	262	300
Other services (net)	295	174	564	947	1,000
Current account balance	-1,650	-3,680	-2,342	-1,267	-1,370
Medium- and long-term capital	356	2,342	1,049	1,202	760
Project and suppliers' credit	356	547	642	754	875
Program loans	230	377	480	495	350
Imports with waiver	124	95	69	49	50
Direct investment	86	53	60	55	80
Petroleum loans	50	215	0	25	0
Loans from banks	-370	165	-182	89	285
Special OECD aid	225	996	315	487	100
Debt repayments ^b	-945	-1,556	-1,185	-1,502	-1,980
Debt relief	600	1,450	850	750	1,000
Short-term capital	-577	-8	80	105	450
Errors and omissions	818	949	1,124	128	350
SDR allocations	27	27	24	0	0
Overall balance	-1,026	-370	-65	168	190
Financing	1,026	370	65	-168	-190
Net use of IMF resources	8	461	335	205	135
Accumulation of arrears	839	0	0	0	0
Change in reserves	-179	91	270	373	325

^a CIA forecast.^b Before debt relief.

output following last year's excellent harvest. Industrial output actually has picked up and is expanding at a 6- to 7-percent pace. Industry will not, however, create enough jobs to stop the decade-long rise in unemployment.

Transition to Democracy

The legislative election on 6 November will bring to an end three years of direct military rule and will constitute an important first step in the transition to democracy—a process that is likely to take most of this decade. Anxious to avoid the proliferation of

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small, frequently extremist, parties that contributed much to past political instability, the generals imposed various hurdles that ultimately eliminated all but three parties from participating in the election [redacted]

Considering the magnitude of Turkey's recent economic difficulties, economic issues have played a surprisingly small role in the campaign. All three parties have tended to couch their economic policy statements in terms of generalities and platitudes. Nevertheless, there are some clear differences, particularly between the Populist Party and the other two:

- The Motherland Party (MP) is closely identified with the views of its founder Turgut Ozal and campaigns with the slogan "free enterprise and market economy." Ozal's goal is to make Turkey a modern, competitive trading nation. He would have the state provide the transportation and communication infrastructure but little more. Thus he favors eventually selling off most public-sector firms engaged in commerce or manufacturing. He is cautious about seeking EC membership, believing that Turkey first needs to develop further.
- The Nationalist Democracy Party (NDP) has sounded more and more like the MP as the election draws nearer, although it probably still favors a somewhat greater role for the state in guiding social development. The party's chief economic spokesman is Memduh Yasa, an economist with views quite similar to Ozal's. Yasa says that the NDP will follow market-oriented policies to build a modern trading state with an open economy. He favors introducing a value-added tax and keeping interest rates above the inflation rate. The party's program calls for selling those public-sector firms that can compete in the marketplace and advocates active pursuit of EC membership.
- The Populist Party (PP) has been less explicit than the others in spelling out its economic program, but it favors a much larger state role.

Party leader Calp has labeled the 1980 stabilization measures as unsuccessful and believes that Turkey needs a mixed economic system combining the human elements of capitalism and socialism. The party would follow more expansionary policies: its manifesto calls for stimulating housing construction and labor-intensive projects, and party spokesmen have advocated cutting interest rates and taking other steps to boost economic growth. [redacted]

Regardless of the election outcome, however, the military has made it quite clear that it will continue to play an important role for some years to come. Former Gen. Kenan Evren, the head of the ruling military council, was elected President last November and will occupy that post until 1989. The military council will be reconstituted in the form of a civilian advisory body to the President. Furthermore, under the constitution approved last year, the powers of the President are substantially increased relative to those of the legislature. [redacted]

Outlook for 1984

Turkey's market-oriented economic policies seem certain to be maintained, and perhaps reinforced, over the next year. Regardless of whether the NDP or MP wins the election, the parliament will have a large conservative majority. Both parties have campaigned on a platform of reducing government economic intervention and increasing Turkey's outward orientation. [redacted]

Domestically, we think that GNP growth in 1984 will pick up to about 5 percent, as the industrial recovery continues strong and agricultural output returns to normal. With the doors to worker emigration still largely closed, however, even this growth rate will not be enough to prevent a small increase in the 20-percent unemployment rate. We expect Ankara to slow monetary growth substantially next year and to reduce slightly the public-sector deficit, but this will be too late to affect the 1984 inflation rate—which should remain around 30 percent. [redacted]

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Prospects for the balance of payments in 1984 appear reasonably good, although debt service payments on earlier reschedulings begin falling due in the second half. The key uncertainty is Turkey's heavy dependence on OPEC countries—particularly Iran and Iraq—as an export market. We think Ankara will continue to use its policy of daily exchange rate adjustments to keep the lira at a competitive level. Under these conditions exports should expand at a faster percentage rate than imports in 1984, holding the trade deficit to about the 1983 level. Net invisibles earnings should increase somewhat, reflecting small gains in tourism and earnings by Turkish contractors in the Middle East. On the capital account Turkey will continue to receive substantial aid, mainly from the IMF, World Bank, and the United States. Foreign investment inflows should increase, although remaining low in absolute terms. With its credit rating gradually improving, Turkey may be able to turn to the banks to cover the remaining financial gap or, failing this, can draw down its foreign exchange reserves.

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Israel: Economic Problems Facing the Shamir Government

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New Finance Minister Cohen-Orgad faces a difficult task in restoring public confidence and in mustering support for his publicly professed goal of reducing personal consumption. Faced with a difficult economic situation and the attendant political pitfalls of austerity, the Shamir government most likely will look to the United States for more aid.

- The external deficit on civilian goods and services increased from \$1.3 billion in 1977 to \$3.2 billion last year.
- Foreign debt nearly doubled from \$11.1 billion at the end of 1977 to \$20.9 billion at the end of last year; Israel increasingly relied on commercial borrowing despite an increase in US aid from \$1.8 billion in FY 1978 to \$2.5 billion in FY 1983, excluding Sinai redeployment aid.

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Begin's Economic Legacy

Former Prime Minister Begin took little interest in economic issues, and, in the few instances when he involved himself in economic policy disputes, he took the politically expedient path. As a result, finance ministers did not have the Begin support that would have been crucial to implement an effective austerity program. For example, the austerity policies announced by former Finance Minister Hurwitz in late 1979 fell apart a few months later, and inflation soared when the Cabinet, with Begin's acquiescence, thwarted Hurwitz's efforts to cut government spending.

Current Situation

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The consequences of Begin's shortsighted policies began to be felt last year as slumping exports produced the first real decline in GNP since 1953. Although recession in the West played a role in the poor export performance, former Finance Minister Aridor's policy of intervening to slow the depreciation of the shekel was also a major factor. Much of the 7.5-percent real increase in private consumption last year was met by imports, in part because of their lower prices in relation to domestically produced goods. Despite Aridor's exchange rate policy and relatively modest price increases of 5 percent a month on government-controlled commodities, last year's inflation rate of 131.5 percent narrowly missed setting a new record.

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The politically expedient economic policies followed during Begin's six-year reign resulted in:

- Real GNP growing at an annual rate of 2.8 percent.
- Real wages increasing at an annual rate of 7.7 percent.
- Private consumption expanding by 6.0 percent annually in real terms.
- The unemployment rate ranging from a low of 2.9 percent in 1979 to a high of 5.1 percent in 1981.

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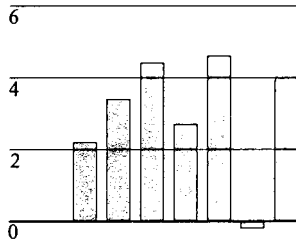
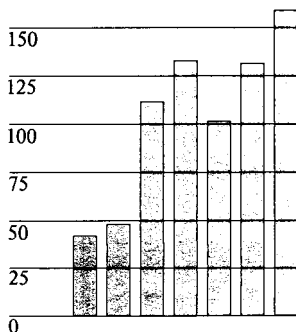
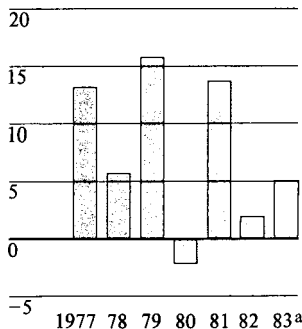
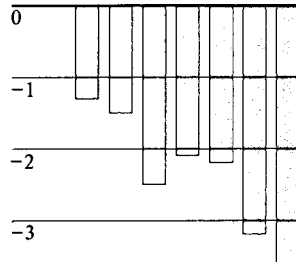
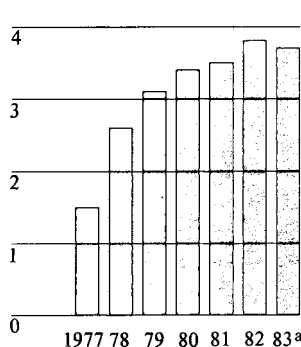
The cost of this record, however, was substantial:

- Inflation accelerated from 42 percent in 1977 to triple-digit levels in the past four years; prices rose a record 133 percent in 1980.

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Secret**Israel: Economic Indicators****Real GNP Growth**
Percent**Consumer Price Growth**
Percent**Real Wages Growth**
Percent^a Projected.**Civilian Goods and Services Balance**
Billion US \$**Foreign Exchange Reserves**
Billion US \$

kets had dropped and that foreign exchange reserves have declined spurred the public in early October to buy US dollars in anticipation of a devaluation. Many Israelis sold stocks, particularly bank stocks, for shekels to purchase dollars, thereby precipitating a stock market crash and forcing its closure. [REDACTED]

In presenting his Cabinet for Knesset approval on 10 October, Prime Minister Shamir said that the government would reduce public and private consumption, cut subsidies, and raise labor productivity. He warned Israelis that the standard of living would not go up until production increased. The Shamir government's first act, taken after an all-night cabinet session immediately following Knesset approval of the new government, was announcement of an 18.6-percent devaluation of the shekel and a 50-percent boost in the price of most government-controlled commodities, including bread and milk. These moves will result in record inflation—we believe prices will rise about 160 percent this year. At the same time, Aridor stated his intention to weaken the indexation system, thereby threatening the cushion Israelis have against rapid inflation. [REDACTED]

Aridor was forced to resign a few days later, however, after his plan to make the US dollar legal tender in Israel was reported in the Israeli press. Opposition in the Cabinet centered on the greater economic dependence on the United States that such a plan would entail. Although Shamir quickly made it clear that Aridor's plan would not be considered by the government, Israelis reacted to the uncertain economic climate by continuing to dump shekels. [REDACTED]

Policy Response

Despite public differences with Aridor over economic policy, Cohen-Orgad supports many of the measures Aridor was trying to implement before

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Israel: Balance of Payments

Million US \$

	1979	1980	1981	1982 ^a	1983 ^b
Civilian goods and services balance	-2,504	-2,121	-2,169	-3,200	-3,600
Exports	8,030	9,791	10,439	10,165	10,850
Goods	4,759	5,798	5,903	5,573	5,450
Services	3,271	3,993	4,536	4,592	5,400
Imports	10,534	11,912	12,608	13,365	14,450
Goods	6,769	7,326	7,250	7,352	7,720
Services	3,765	4,586	5,358	6,013	6,730
Self-financed military imports	250	250	-424	174	-104
Military import payments	1,420	2,018	1,483	2,295	1,930
US military assistance	1,170	1,768	1,907	2,121	2,034
Debt repayment (medium- and long-term)	893	1,025	1,152	1,525	1,635
Financial gap	3,647	3,396	2,897	4,899	5,131
Sources of financing	4,085	3,684	3,042	5,242	5,031
Unilateral transfers	1,400	1,474	1,584	1,422	1,530
US economic assistance	980	785	785	785	785
Israeli bonds	414	450	518	557	580
Other capital including net short-term borrowing	1,240	968	118	2,434	2,136
Net direct investment	51	7	37	44	0
Change in reserves	438	288	145	343	-100

^a Estimated.^b Projected.

his resignation. Cohen-Orgad has publicly supported budget cuts, including subsidies, and reductions in cost-of-living adjustments. His differences with Aridor are primarily over style rather than substance. Cohen-Orgad has publicly stated that Aridor was not honest with the public by not stating the hard facts about the economy and that Israelis would support austerity measures once the need for them was clearly presented. Unlike Aridor, Cohen-Orgad will probably not seek cuts in the defense or settlements budgets because of his close ties to Defense Minister Arens and his commitment to the West Bank, according to reporting from the US Embassy; he lives in a West Bank settlement and is chairman of the board of a company that raises capital for investment in high-technology industries in the West Bank.

Cohen-Orgad faces a difficult task in getting and keeping cabinet and popular support for austerity. Members of TAMI—a small party in the coalition whose constituency is low-income Israelis—can be expected to oppose cuts in social welfare spending and subsidies, particularly if defense and settlement spending are untouched. Other members of the coalition would probably oppose reductions in traditional public services, such as health care and education.

Opposition to efforts to reduce cost-of-living adjustments can be expected from the Histadrut, the Israeli labor confederation, even though Cohen-Orgad has pledged to work with its officials. A Histadrut official recently told a US Embassy officer that, although the Histadrut is willing to

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Options for a Sick Economy

Even if the Shamir government enforces the recent budget and subsidy cuts agreed to when Aridor was Finance Minister, it will still face higher inflation, rising unemployment, and a widening foreign financial gap.¹ Using the CIA's model of the Israeli economy, we project the financial gap under current policies would reach \$6.4 billion in 1986 compared with \$4.9 billion last year. Past budget cuts have been known not to materialize because ministers have become adept at using "unanticipated" price hikes to justify actual outlays. For example, in FY 1982, which ended on 31 March, civilian expenditures rose 2.6 percent in real terms, based on Finance Ministry estimates, despite "cuts" approved in August 1982 to help finance the invasion of Lebanon. Should Aridor's cuts similarly go by the wayside—our baseline scenario—we believe the foreign financial gap would reach \$7.1 billion in 1986. []

It is highly unlikely that traditional sources of foreign exchange—transfer payments and Israeli bond sales—would grow enough to cover the larger gap. The hoped-for increase in financial support from abroad in the wake of the invasion of Lebanon last year did not materialize. The \$39 million increase in Israeli bond sales last year was more than offset by a drop in unilateral transfers of \$162 million, and Israeli officials undoubtedly hope this is not the start of a new trend. []

¹ The foreign financial gap is the sum of the civilian goods and services deficit, self-financed military payments, and debt repayment. []

Officials of the large trade union organization, the Histadrut, are under little pressure to moderate wage demands in order to protect jobs. Histadrut officials believe that any Israeli government will hold to the longstanding commitment to provide jobs for foreign Jews taking up permanent residence in Israel and will remain extremely sensitive to unemployment. Thus, under our baseline scenario, real wage gains boost private consumption by an annual rate of nearly 7 percent in 1984-86. These demand pressures, combined with continued budget deficits, are likely to push inflation to new records. []

We have also considered a number of alternative scenarios to measure the impact of various policies on Israel's economic performance. The results demonstrate that Israel must reverse the recent decline in exports to prevent the financial gap from widening. A 10-percent annual increase in export volume in 1984-86 would result in a financial gap of \$4.6 billion in 1986. We do not believe, however, that such an increase in exports is likely as long as domestic demand remains buoyant. A more modest increase in exports of 5 percent a year in real terms would result in a financial gap in 1986 that would exceed the 1982 level by \$1.7 billion. Constraining domestic demand alone would increase unemployment to double-digit levels, and the financial gap in 1986 would still exceed the 1982 level. A combination of modest export and private consumption growth and cuts in domestic government consumption would prevent the financial gap from increasing much but would still lead to increased unemployment. []

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discuss other issues with the government, it is unwilling to negotiate reductions in real wages or changes in the cost-of-living adjustment formula. According to reporting from the Embassy, Histadrut officials believe that the two-hour strike on 16 October by 70 percent of the labor force gives them a mandate for a forceful defense of their position. []

Even if the Shamir government does launch an austerity effort, it would probably be short lived. We do not believe that this government, with the bickering parties that make up the coalition, has the political will to stick with such a program for the length of time—two to three years—that would

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Israel: Alternative Economic Scenarios

	Real GNP Growth (percent)			Unemployment Rate (percent)			Financial Gap (billion US \$)		
	1984	1985	1986	1984	1985	1986	1984	1985	1986
Baseline Scenario (assumes budget cuts are not implemented)	6.7	5.8	3.7	6.9	6.8	6.9	5.9	6.3	7.1
Scenario 1 (assumes budget cuts are implemented)	-0.1	3.5	4.6	7.6	8.9	9.8	5.7	5.8	6.4
Scenario 2 (assumes real export growth of 10 percent in 1984-86)	10.8	10.7	8.4	6.5	5.3	3.8	5.3	5.0	4.6
Scenario 3 (assumes real export growth of 5 percent in 1984-86)	7.1	6.8	5.3	6.9	6.6	6.3	5.9	6.1	6.6
Scenario 4 (assumes real private consumption growth of 2 percent in 1984-86; cuts in government civilian consumption of 3 percent, 2 percent, and 1 percent in 1984-86, respectively; cuts in domestic military consumption of 5 percent in 1984-85 and no growth in 1986)	1.6	0.8	1.2	7.4	8.7	10.2	5.6	5.6	6.0
Scenario 5 (combines scenarios 3 and 4)	2.2	1.8	2.6	7.4	8.5	9.6	5.5	5.3	5.3

be required for it to work. Whatever public acceptance of the need for belt tightening existed a few weeks ago probably has been destroyed in the furor over Aridor's "dollarization" plan. Israelis, who have been scrambling to protect their assets in recent weeks, are looking for a period of stability and a continuation of the rising standard of living they have enjoyed in recent years. They probably will oppose any proposals that threaten the status quo, such as lower subsidies, reduced public services, or lower cost-of-living adjustments. []

Rising unemployment, which would result if Cohen-Orgad is able to implement the austerity policies he has advocated, holds the greatest potential for causing political problems for the government. Cohen-Orgad would probably be forced to back off once unemployment rises above the politically sensitive level of 5 percent. The resulting increase in inflation would be tolerated as long as existing indexation remains in place. []

Implications for the United States

We believe that politically expedient actions to hold down unemployment and to continue indexation policies would lead to a foreign exchange crunch unless Washington increases its financial support. Despite Cohen-Orgad's publicly stated desire to reduce Israel's financial dependence on the United States, we believe the Shamir government will take the easier path by asking for increased aid on better terms. It could also ask for generous debt relief. Additional assistance would allow the Israelis to postpone dealing with the balance-of-payments problem. []

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Central America: Grim Economic Prospects

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Insurgent activity and the associated climate of uncertainty will remain the most critical factors influencing Central American economic performance at least through 1984.¹ World demand for agricultural commodities and foreign aid will be important in determining the availability of desperately needed foreign exchange, but business and government investment decisions—colored by guerrilla actions—will direct the course of economic development. If insurgent activity continues near current levels, we calculate that the foreign aid tab to avert further drops in real GDP this year and next would reach \$2.5 billion annually. We believe that this level of aid is unlikely, however, and that regional economic activity will fall by 3 to 5 percent this year and—at best—stagnate in 1984.

Shaken by Change: 1979-82

Regional economic growth fizzled in 1979 when the beginning of sustained insurgent activity coincided with dramatic deterioration in external terms of trade. In those countries plagued by the fighting, damage and losses directly disrupted economic activity. Throughout the region, the specter of instability darkened the investment climate and dampened foreign lending. Violence and guerrilla intimidation in the countryside reduced agricultural labor migration and cut into harvests. Manufacturing withered as intraregional commerce dropped precipitously. The doubling of oil prices, softening world demand for agricultural commodities, and higher interest rates compounded these problems.

By the end of 1982, real economic activity, measured in US dollars, plunged nearly 20 percent from the 1979 peak, a drop of about one-third in per

¹ For the purposes of this article, we exclude Belize and Panama from our discussion.

capita terms. Deterioration was the most severe in El Salvador, where output slid about 25 percent. Throughout the region, governments struggled to cope with mounting economic chaos. Austerity programs designed to control inflation and mollify foreign lenders drained political support from those segments of society most hurt by rising unemployment, higher taxes, and declining public expenditures on social services.

Near-Term Outlook

The most significant and volatile variable in the economic outlook for Central America through 1984 is the security situation. The region's political, military, and economic linkages are so pervasive as to make it unlikely that continuing turmoil in any one country could be isolated. We judge that ongoing difficulties in any country will undermine the sort of revival in investor confidence and trade that is crucial to economic recovery throughout the region. Accordingly, we examined economic performance and necessary foreign funding for the region under various levels of insurgent activity.

Key Constraints. Regardless of military developments, however, certain insurmountable factors will constrain economic activity. Thus, despite brightening prospects for the international economy, lower world interest rates and oil prices, apparent progress on regional austerity programs, and fairly generous foreign aid projections, Central America probably will be unable to achieve dramatic economic improvement at least through 1984:

- The spectacular surge in commodity prices needed to overcome the region's foreign exchange difficulties is unlikely to occur even if global

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economic recovery is stronger than generally expected.

- Without larger aid disbursements than now seem likely, foreign funding will be inadequate to boost imports significantly.
- Potentially positive external influences, such as inclusion in the Caribbean Basin Initiative, will take several years to reach maximum effectiveness, under the best of circumstances.
- Production in the region's integrated manufacturing sectors will remain 40 to 50 percent below capacity until the existing tangle of commercial arrears between the Central American countries is straightened out. In addition, depleted industrial capital stock and inventories will take time to correct.
- Uncertainty over land reform and past neglect of fields and equipment will hold down agricultural production.
- Even if regional chaos subsides, businessmen will remain chary of making substantial new investment for several years.
- The shrunken tax base will limit governments' ability to raise funds to finance public-sector growth.

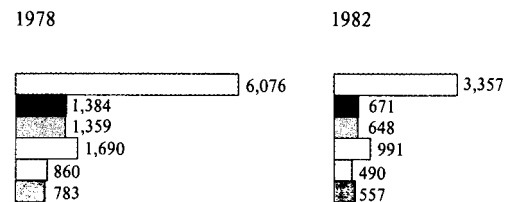
Impact of Insurgency. Despite the probable ebbs and flows in the fighting, we judge that no significant change is likely to occur in the balance between insurgent and military forces throughout the region. Military developments in El Salvador, probably the most reliable barometer of upheaval in the region, continue to appear essentially stalemated. The insurgency in Nicaragua, another potential harbinger of major regional change, appears incapable of threatening the Sandinistas' hold on power any time soon. Although we cannot rule out sudden developments such as coups or assassinations that would modify the current political situation, we believe that such events would not prove disruptive for any length of time unless they were accompanied by a critical shift in the military balance.

Central America: Economic Indicators

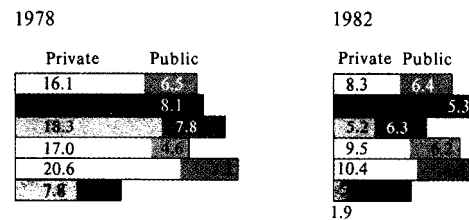
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Central America
Costa Rica
El Salvador
Guatemala
Honduras
Nicaragua

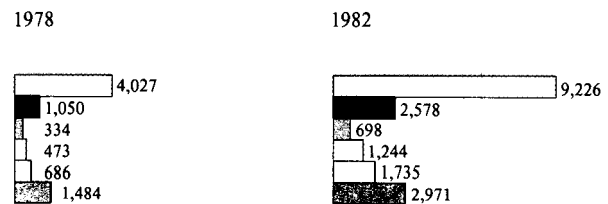
Imports by Type Million 1980 US \$



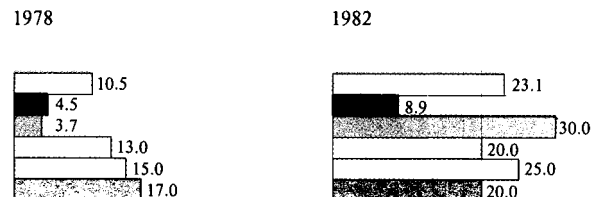
Gross Domestic Investment as a Share of GNP Percent



External Public Debt Million US \$



Unemployment Rates Percent



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Secret**Central America: Projected Foreign Financing Gap, 1984 ^a**

	1983		1984	
	No GDP Growth	3- to 5-Percent GDP Decline	3-Percent GDP Growth Following No Growth in 1983	3- to 5-Percent Decline Following 3- to 5-Percent Decline in 1983 ^b
Current account	-2,003	-1,265	-2,382	-1,193
Trade balance	-743	-5	-1,087	102
Exports (f.o.b.)	4,076	4,076	4,228	4,228
Imports (c.i.f.)	4,819	4,081	5,315	4,126
Net services and transfers	-1,260	-1,260	-1,295	-1,295
Amortization	537	537	609	609
Foreign financing gap	-2,540	-1,802	-2,991	-1,802

^a Assumes no change in the security conditions. Export earnings could fall slightly from those shown if the tentative recovery in commodity prices now apparently under way stalls.

^b Assumes no change in current foreign financing levels.

Under these circumstances, the level of foreign financial support needed merely to avert further economic declines would be sizable. We calculate that the region would need about \$2.5 billion in both 1983 and 1984. To reach 3-percent growth—the minimum needed to sustain per capita income—next year, \$3 billion would be required for the region as a whole.

Because foreign exchange reserves are nearly depleted in all countries and prospects for commercial lending are bleak, foreign aid will determine actual import levels and growth rates. Aid now anticipated from official sources, however, falls short of our projected requirements. We estimate that Central America will receive about \$1.8 billion in hard currency assistance in 1983, of which about \$600 million will come from multilateral lenders, including the IMF. Bilateral sources are expected to contribute \$1.2 billion, including roughly \$450 million from the United States, the largest individual lender. We doubt that aid levels will increase significantly in 1984. Even if Central American countries manage to adhere to austerity programs

necessary for IMF and other multilateral assistance, these agencies probably will continue to face shortages of lendable funds. The Central American Bank for Economic Integration for example, a small but important source of aid in the past, verges on insolvency. Most bilateral lenders probably will continue to offer only small aid packages until the regional turmoil is resolved.

Lacking sufficient aid, we calculate economic output in the region as a whole will fall 3 to 5 percent this year and—at best—could stagnate in 1984 only if donor largesse increased somewhat beyond current levels. Even in Costa Rica and Honduras, where prospects are brightest, no growth is expected next year. Political pressures will mount throughout the region in the wake of rising unemployment, increasing bankruptcies, and shrinking consumption.

Deterioration will be most pronounced in **El Salvador**, where another 5 percent loss in economic output is likely this year and next, furthering the

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insurgents' goal of crippling the economy. Although steadily worsening economic conditions may detract from popular support for the guerrillas, we believe there is a serious risk that the government's longstanding inability to arrest the economic slide will work to the advantage of the extreme right in the upcoming elections.

Economic performance probably will be similarly weak in **Guatemala**. Following a roughly 4-percent decline this year, a bottoming out is possible in 1984 if the government manages to stick to the terms of the new IMF program, but growing political strains are making that course less likely. The Mejia regime already has scaled back the contentious value-added tax in response to pressure from far right elements in the military and business communities. The resultant budget squeeze will force deeper cuts in social services and public works programs, according to the US Embassy, if Guatemala is to stay within IMF credit ceilings. Growing economic hardship probably will have the most pronounced effect on the poor and will provide fresh opportunities for exploitation by the guerrillas.

The faltering economy in **Nicaragua** probably will slip roughly 3 to 5 percent this year and in 1984, and we believe Managua will search for ways to protect living standards of the lower class, the Sandinistas' core of popular support. We expect that taxes on the middle class will increase and that property confiscations will be speeded up. For example, to shore up popular support, the government recently hastened the distribution of nationalized farmland to peasants in areas affected by the counterinsurgency.

In **Honduras**, economic decline of about 2 percent in 1983 is likely to be followed by no growth in output in 1984 even if Tegucigalpa continues to adhere to rigorous IMF-mandated austerity. Nevertheless, popular support for the government—now bolstered by the perceived threat from Nicaragua and the expectation that President Suazo will attract large amounts of US aid—could weaken, and labor unrest and popular agitation could grow in the face of expected increases in bankruptcies

and unemployment. Moreover, peasant land invasions could rise because the government is short of funds for legal expropriation of land.

In **Costa Rica**, projected economic decline of about 2 percent this year and stagnation—at best—in 1984 will test President Monge's willingness and ability to adhere to the austerity measures crucial to undergird long-term economic recovery. Recent widespread protests prompted the government to rescind planned utility rate hikes, and Monge's substantial public support is eroding. Not surprisingly, next year's budget proposal, currently under legislative consideration, contains inflationary spending measures that could torpedo the IMF program and reverse the progress made on debt rescheduling with foreign creditors.

In the event that the military situation shifts markedly in favor of the insurgents in El Salvador and possibly in Guatemala and Nicaragua, subversive activity could become more widespread in Honduras and Costa Rica. Although it is impossible to predict the regional military and political outcome of such developments, the economic impact would be clear:

- Production losses directly attributable to the fighting would accelerate in El Salvador, Nicaragua, and Guatemala and could become a factor in economic decline in Costa Rica and Honduras.
- Total investment would plunge as increased military spending strained the shrinking tax base and soaked up funds previously allocated to public development projects.
- The flight of capital and manpower would surge as investors smuggled assets out of the troubled region. In addition to peasants fleeing the violence, emigration of skilled labor and managers needed to accomplish any economic turnaround also would rise.

Increased violence would shift production patterns markedly. In agriculture, cultivation of export

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crops would wane and farmers—and others—would revert to subsistence crops. Regional commerce would all but collapse, and manufacturing sectors probably would remain active only to the extent that factories could be retooled to produce defense materials.

In these bleak circumstances, foreign aid needed to ward off economic decline in 1984 would substantially exceed \$3 billion. Moreover, foreign aid would do no more than prop up imports and living standards. Because compliance with austerity programs would become increasingly difficult—both from a political and economic perspective—new lending from multilateral sources would be highly unlikely. Countries would turn their appeals toward bilateral lenders, particularly the United States.

On the other hand, even if government forces achieve decisive victories in El Salvador, Guatemala, and Nicaragua, the region's economies would take time to rebound:

- Guerrilla damage already inflicted would be costly and time-consuming to repair.
- Foreign and domestic lender and investor confidence would be slow to revive even under optimum security conditions.
- Governments would be largely unable to compensate for soft private investment.
- Demands for wage hikes would add to production costs throughout the region as labor struggled to regain former living standards.
- Low inventories and cannibalized equipment would constrain manufacturing.

Foreign aid needs would most likely remain high for, perhaps, a decade. Depending on the thrust of Central American political developments, we believe bilateral and multilateral lenders might step up aid programs substantially.

The Cost of Prolonged Insurgency

If insurgent activity drags on into mid-decade, the costs of eventual economic reconstruction would soar. The longer the fighting continues, the more

damage would be done to farms, factories, transportation networks, and utilities, and the steeper would be the final repair bill. Private capital stock, already neglected, would depreciate further. Businessmen who have found ingenious ways to move their assets out of the region would have little reason to stay, and the drain of managerial and technical talent would be difficult to reverse.

The longer that the battlefield is the arena for settling conflicts, the smaller the eventual role of the private sector would be in rebuilding the economies. Governments—working with minimal domestic capital resources, a depleted tax base, and generally lacking the skills found in the entrepreneurial class—would assume the key role in economic decisionmaking. This major departure from the private-sector-led growth path of the 1960s and 1970s probably would result in much slower growth, reduced access to private foreign capital, and a chronic demand for foreign aid.

Implications for the United States

Economic aid will become an increasingly important feature in US-Central America relations in the coming years. Not only would continuing economic turmoil aggravate the already volatile political and military balance in a region vital to US security interests but the Central American countries would petition Washington for aid with increasing urgency should weakening resolve to stick to tightening austerity measures—as we expect—jeopardize IMF and other multilateral funding. Honduras and Guatemala already have high expectations of US aid, and unrealistic hopes would likely lead to periodic misunderstandings. At the same time, other potential donors would be watching the US lead. Moreover, the number of Central American refugees entering the United States illegally to seek relief from intolerable military, political, and economic conditions would grow.

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Although the broader implications of a continuing economic decline in Central America would be serious, the direct financial costs to the United States would be relatively small. US private investment in the region currently totals less than \$800 million, according to Commerce Department estimates. Of that investment, more than half of it is concentrated in Costa Rica and Guatemala. US trade with Central America, which has been declining steadily since 1979, fell to about \$1.4 billion in each direction in 1982. US trade is distributed roughly evenly among all countries except Nicaragua, where it is substantially lower. Agricultural commodities readily available elsewhere on world markets account for the lion's share of US purchases from Central America. Because of continuing problems with overdue accounts, many US exporters authorize new shipments to the countries only when payment is guaranteed in advance. Although a large chunk of Central America's commercial debt is held by US banks, the region's outstanding debt to these banks is dwarfed by that of other Latin American countries.

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